

Before the  
FEDERAL COMMUNICATIONS COMMISSION  
Washington, DC 20554

DOCKET FILE COPY ORIGINAL

In the Matter of:

Ameritech Corporation Telephone  
Operating Companies' Continuing  
Property Records Audit

Bell Atlantic (North) Telephone  
Companies' Continuing Property Records  
Audit

Bell Atlantic (South) Telephone  
Companies' Continuing Property Records  
Audit

BellSouth Telecommunications'  
Continuing Property Records Audit

Pacific Bell and Nevada Bell Telephone  
Companies' Continuing Property Records  
Audit

Southwestern Bell Telephone Company's  
Continuing Property Records Audit

U S West Telephone Companies'  
Continuing Property Records Audit

RECEIVED

SEP 23 1999

FEDERAL COMMUNICATIONS COMMISSION  
OFFICE OF THE SECRETARY

CC Docket No. 99-117

ASD File No. 99-22

COMMENTS OF U S WEST COMMUNICATIONS, INC.

James T. Hannon  
Suite 700  
1020 19th Street, N.W.  
Washington, DC 20036  
(303) 672-2860

Attorney for  
U S WEST COMMUNICATIONS, INC.

Of Counsel,  
Dan L. Poole  
September 23, 1999

No. of Copies rec'd  
List ABCDE

0+4

## TABLE OF CONTENTS

	<u>Page</u>
SUMMARY .....	ii
I. INTRODUCTION .....	4
II. THE ASD'S AUDIT OF U S WEST'S CPR IS FATALLY FLAWED AND PROVIDES NO BASIS FOR ADJUSTING COE ACCOUNTS .....	5
III. ISSUES DESIGNATED FOR INVESTIGATION .....	8
IV. CONCLUSION .....	31

## SUMMARY

This is U S WEST Communications, Inc.'s ("U S WEST") third opportunity to comment on the Accounting Safeguards Division's ("ASD") 1997 audit of U S WEST's continuing property records (or "CPR") for hardwired central office equipment ("COE"). The ASD's audit report is virtually unchanged from the first version that was provided to U S WEST in July 1998. While U S WEST commends the Federal Communications Commission ("Commission") for "not passing judgment" on the report's findings, conclusions, and recommendations and initiating this Notice of Inquiry, U S WEST is extremely disappointed with the ASD's decision to disregard virtually all management input and its attempt to draw conclusions with respect to all hardwired COE investment on the basis of a fatally flawed sample.

In its Notice the Commission identified ten issues on which it invited public comment. Issue 8 is of special interest in that it represents the first time that the issue of customer rate impact has been raised formally with respect to the CPR audits. Rather than provide any parties with false hopes, the Commission should immediately take "official notice" of the fact that -- regardless of whether the CPR audit findings are correct or not -- there would be no customer rate impact under remaining life depreciation and price cap regulation.

The first issue in the Notice addresses the validity and reasonableness of the auditors' statistical sampling methodologies. In the second issue the Commission invites comment on the validity and reasonableness of the auditors' rescoring

methodology. Issues 3-10 are predicated on the assumption that the ASD's sampling and rescoring methodologies are valid and reasonable. If they are not -- as U S WEST contends -- Issues 3-10 merely become hypothetical inquiries and answers to these inquiries provide no basis for taking any action.

One would be hard-pressed to claim with a straight face that the ASD's sample is "representative" of U S WEST's hardwired COE investment. The ASD field audits covered a miniscule portion of the Regional Bell Operating Companies' ("RBOC") hard-wired COE investment. For U S WEST, the ASD selected a sample of 33 central offices ("CO") -- out of a total population of over 1,700 COs -- and 36 CPR line items per office for a total of 1,188 line items out of approximately 500,000 records.

This audit sample of 1,188 items is the foundation on which the ASD's findings and recommendations are built. If the sample is not representative of U S WEST's entire hardwired COE investment -- and it is not -- it cannot be used to produce statistically valid estimates of this population. At a minimum, the ASD's sample suffers from the following defects:

- The unexplained exclusion of 500 U S WEST COs from the population from which the audit sample was selected.
- The failure to provide a rationale for using a large number of strata with relatively few CO selections per strata.
- The failure to use sampling techniques which take into account the wide variation in the dollar-value of CPR items.

In addition to starting with an unrepresentative sample, the ASD's audit also suffers from numerous other defects including:

- The ASD's failure to follow generally accepted government auditing standards.
- The failure to consider "understatement" errors as well as errors of "overstatement."
- The failure to consider U S WEST's documentation indicating that the majority of the ASD's audit findings were resolved.
- The announcement of a much more stringent "rescoring" methodology than is normally used in audits -- long after the completion of field audits and management responses.

Thus, while there may be merit in addressing the specific issues raised in the Notice, the Commission should not lose sight of the ASD's audit as a whole. There is not just "one weak link;" there are many. The ASD's audit results cannot be saved by fixing a few minor errors. The audit is fatally flawed from the selection of the initial U S WEST sample to the ASD's extrapolation to the entire universe of COE hardwired investment. As such, the Commission should not attempt to draw any conclusions from the ASD's audit with respect to the status of U S WEST's hardwired COE investment.

U S WEST acknowledges that its continuing property records are not error-free. This would be unheard of given the detailed nature of the Commission's Part 32 rules which require CPR cost support data to be maintained for the life of the equipment regardless of the value of the investment. U S WEST also acknowledges that its internal processes for maintaining continuing property records could be improved and that it is taking steps to correct any deficiencies in its processes. U S WEST is willing to work with the Commission to address concerns that the Commission might have with respect to U S WEST's records. However, U S WEST

would be remiss if it did not express both its concern and dissatisfaction with the ASD's audit report. The report neither recognizes the extraordinarily detailed and burdensome nature of the Commission's continuing property recordkeeping rules, nor U S WEST's efforts to comply with these rules and correct inaccuracies in the ASD's field audit.

Before the  
FEDERAL COMMUNICATIONS COMMISSION  
Washington, DC 20554

In the Matter of:	)	
	)	
Ameritech Corporation Telephone	)	
Operating Companies' Continuing	)	
Property Records Audit	)	
	)	
Bell Atlantic (North) Telephone	)	
Companies' Continuing Property Records	)	
Audit	)	
	)	
Bell Atlantic (South) Telephone	)	CC Docket No. 99-117
Companies' Continuing Property Records	)	
Audit	)	
	)	
BellSouth Telecommunications'	)	ASD File No. 99-22
Continuing Property Records Audit	)	
	)	
Pacific Bell and Nevada Bell Telephone	)	
Companies' Continuing Property Records	)	
Audit	)	
	)	
Southwestern Bell Telephone Company's	)	
Continuing Property Records Audit	)	
	)	
U S West Telephone Companies'	)	
Continuing Property Records Audit	)	

**COMMENTS OF U S WEST COMMUNICATIONS, INC.**

U S WEST Communications, Inc. ("U S WEST"), through counsel and pursuant to the Federal Communications Commission's ("Commission") Notice of Inquiry, hereby responds to the issues raised with respect to the Common Carrier Bureau, Accounting Safeguards Division's ("ASD") audits of continuing property records (or "CPR") for hardwired central office equipment ("COE") of U S WEST and

the other above-captioned Regional Bell Operating Companies ("RBOC").<sup>1</sup> Simultaneously, the Commission released a Public Notice in which the ASD explained for the first time the evidentiary standard that it employed in determining whether its field audit findings should be modified (i.e., reclassified or rescored).<sup>2</sup> This Public Notice was incorporated by reference into the instant proceeding. In releasing its Notice, the Commission made clear that it "had not passed judgment" on either: 1) the accuracy of the audit reports, their findings or conclusions; or 2) the accuracy or merit of the ASD's procedures for rescoring field audit findings.<sup>3</sup>

Numerous press articles and parties over the past year have implied that the CPR audits may have a direct impact on customer rates. There is no basis for this suggestion. Regardless of whether the CPR audits were conducted properly or whether the ASD's findings are correct, there would be no rate impact if remaining

---

<sup>1</sup> In the Matters of: Ameritech Corporation Telephone Operating Companies' Continuing Property Records Audit; Bell Atlantic (North) Telephone Companies' Continuing Property Records Audit; Bell Atlantic (South) Telephone Companies' Continuing Property Records Audit; BellSouth Telecommunications' Continuing Property Records Audit; Pacific Bell and Nevada Bell Telephone Companies' Continuing Property Records Audit; Southwestern Bell Telephone Company's Continuing Property Records Audit; US West Telephone Companies' Continuing Property Records Audit, Notice of Inquiry, 14 FCC Rcd. 7019 (1999) ("Notice").

<sup>2</sup> Public Notice, The Accounting Safeguards Division Releases Information Concerning Audit Procedures For Considering Requests By The Regional Bell Operating Companies To Reclassify Or "Rescore" Field Audit Findings Of Their Continuing Property Records, 14 FCC Rcd. 6243 (1999) ("Rescore Public Notice").

<sup>3</sup> Notice, 14 FCC Rcd. at 7019 ¶ 1 and 7021 n.2.



life depreciation is employed, as is required by the Commission.<sup>4</sup> To put things in proper perspective and to avoid much acrimonious debate, the Commission should take “official notice” of the fact that the CPR audit results cannot have an impact on customer rates under remaining life depreciation and price cap regulation.<sup>5</sup> By taking this action the Commission could refocus the debate in this proceeding on the appropriateness of the Commission’s continuing property recordkeeping requirements and RBOC compliance with these rules.

In the following sections, U S WEST responds to the issues raised in the Notice and urges the Commission to reject the ASD’s audit findings as fatally flawed. A large part of this response is based on U S WEST’s earlier reply to the ASD’s audit report which was filed with the Commission prior to the public release of the audits.<sup>6</sup>

---

<sup>4</sup> For a more thorough discussion of this point, see U S WEST’s response to Issue 8 at pages 25-28 below.

<sup>5</sup> The Federal Rules of Evidence allow a Court to take judicial notice of facts at any stage of a proceeding. (See Fed. R. Evid. 201.) With few exceptions, the Commission’s rules incorporate “the rules of evidence governing civil proceedings in matters not involving trial by jury in the courts of the United States.” (47 C.F.R. § 1.351). As such, the Commission has the authority to take notice of facts which “are not subject to reasonable dispute” and has done so in the past. (See, In re Applications of Liberty Cable Co., Inc. For Private Operational Fixed Microwave Service Authorization and Modifications, New York, New York, Initial Decision of Administrative Law Judge Richard L. Sippel, 13 FCC Rcd. 10716, 10750 ¶ 59 n.30 (1998) (“Official notice is taken of the applications. . . . [s]ee Fed. Rev. 201 and 47 C.F.R. §[1].351 (Rules of evidence)”; see also 47 C.F.R. § 1.203 for references to “official notice” in the record of a Commission hearing.

<sup>6</sup> On January 11, 1999, U S WEST filed a response to the ASD’s December 22, 1998 draft report of its audit of U S WEST’s continuing property records and incorporates those comments herein at Attachment 1 (“U S WEST Response”). The Commission publicly released the ASD’s draft audit report and U S WEST’s response on March 12, 1999. See In the Matter of US West Telephone Operating Companies’

## I. INTRODUCTION

This is U S WEST's third opportunity to comment on the ASD's 1997 audit of U S WEST's continuing property records for hardwired COE. The ASD's audit report is virtually unchanged from the first version that was provided to U S WEST in July 1998. While U S WEST commends the Commission for "not passing judgment" on the report's findings, conclusions, and recommendations and initiating this Notice, U S WEST is extremely disappointed with the ASD's decision to disregard virtually all management input and its attempt to draw conclusions with respect to all hardwired COE investment on the basis of a fatally flawed sample.

While there may be merit in addressing the specific issues raised in the Notice, the Commission should not lose sight of the ASD's audit as a whole. There is not just "one weak link;" there are many. The ASD's audit results cannot be saved by fixing a few minor errors. The audit is fatally flawed from the selection of the initial U S WEST sample to the ASD's extrapolation to the entire universe of COE hardwired investment. As such, U S WEST would be remiss if it did not make some general observations on the deficiencies of the ASD's specific audit of U S WEST prior to addressing the specific issues on which the Commission invited public comment.

---

Continuing Property Records Audit, Order, 14 FCC Rcd. 5731 (1999). Previously, on August 19, 1998, U S WEST filed a response to the ASD's draft audit report which was made available to U S WEST on July 20, 1998. This response formed the basis of U S WEST's January 11, 1999 response ("U S WEST Response").

## II. THE ASD'S AUDIT OF U S WEST'S CPR IS FATALLY FLAWED AND PROVIDES NO BASIS FOR ADJUSTING COE ACCOUNTS

One of the first steps in the ASD's audit of U S WEST was to select a sample of Central Offices ("CO") to be audited which was representative of the entire population (of COs). U S WEST provided information on over 1,700 offices. In selecting a sample of 33 COs, the ASD excluded over 500 of these offices -- without explanation -- prior to stratification or sample selection. The ASD's failure to delineate the basis or criteria for excluding these offices raises questions about "whether the population is appropriate for the audit objectives or whether the offices selected are likely to be representative of the population of offices." These concerns are exacerbated by the ASD's replacement of certain "randomly" selected COs and its approach to stratification (*i.e.*, large number of strata with few selections per strata).<sup>8</sup>

Another aspect of the ASD's sample selection which calls into question the validity of any of its dollar-based extrapolations is the ASD's decision to randomly select CPR line items. Random sampling fails to take into account the value of an item. In order to allow for the appropriate coverage of higher value items, it is standard practice to use dollar-based selection techniques when sampling from

---

<sup>7</sup> Attachment 1, U S WEST Response, Thornton Letter dated Aug. 18, 1998, at 2 ("U S WEST Response, Thornton Letter dated Aug. 18, 1998"). Ms. Thornton is Deloitte & Touche's "quantitative techniques" expert and is well-known in the field of statistical audit procedures. U S WEST engaged Deloitte & Touche in August 1998 to review the ASD's draft CPR audit report.

<sup>8</sup> Attachment 1, U S WEST Response at 16.

accounting populations.<sup>9</sup> The use of random sampling to select CPR line items for audit purposes implies that a carrier is just as likely to lose track of a high value item as a low value item. Clearly, this is not true -- no for-profit business values inexpensive items and expensive items equally. Thus, if a random sample is used to estimate an accounting population such as COE hardwired investment, any such estimate will have a significant bias.<sup>10</sup>

The ASD's deficient sample selection techniques ensured that the audit results would be flawed before auditors even initiated their field visits to U S WEST COs. While one can challenge the ASD's restrictive field audit procedures,<sup>11</sup> U S WEST's main complaint is that the ASD has failed to consider management input on inaccuracies in the field audit. Most recently, the ASD has attempted to bolster its field audit findings by releasing an after-the-fact Public Notice which purports to provide an explanation of the standard that was employed for revising field audit results.<sup>12</sup> This belated explanation is not sufficient to justify either the rejection of U S WEST management input or the ASD's alleged findings.<sup>13</sup>

---

<sup>9</sup> Attachment 1, U S WEST Response, Thornton Letter dated Aug. 18, 1998 at 2-3; also see Attachment 2, Geppert Declaration at 8 ("Geppert Declaration").

<sup>10</sup> The current CPR audits demonstrate that audit results can be skewed significantly by the failure to differentiate between investment items on the basis of dollar value. Of the 1,188 items in the U S WEST audit sample, 449 items (38%) had a cost below \$2,000 per item (excluding the 14 items that had an in-place cost of zero). The total value of the 449 items only represented 3% of the total dollar value of the sample.

<sup>11</sup> See Attachment 2, Geppert Declaration at 8-10.

<sup>12</sup> See Rescore Public Notice, 14 FCC Rcd. 6243.

<sup>13</sup> See also, Attachment 2, Geppert Declaration at 11-14.

Putting aside all of the problems with the ASD's sample selection (i.e., both of COs and CPR line items) and field audit results, numerous issues remain with respect to the validity of the ASD's estimates (i.e., extrapolations to the entire population) which are based on this sample. Of particular concern is that the total range of uncertainty (i.e., \$394.8 million) of "not found" COE investment exceeds the ASD's estimate of \$378.6 million. As Ms. Thornton, Deloitte & Touche's "quantitative techniques" expert, states:

In most instances, an estimate with such large precision [range of uncertainty] would be of little predictive value without the support of independent corroborative information to assist in determining whether any point in the estimated range is reasonable.<sup>14</sup>

Ms. Thornton also notes that some government agencies have adopted guidelines for precision and confidence intervals which are a fraction of those used in the ASD's estimate of "missing" hardwired COE for U S WEST.<sup>15</sup> The ASD's use of an estimate with such a large range of uncertainty does not pass statistical scrutiny and is of little or no use for decision-making purposes.

To compound the problem, the ASD persists in its claim that the best estimate of the cost of "not found" COE investment is the mid-point of the range of uncertainty.<sup>16</sup> This contention is not supported by sampling theory.<sup>17</sup> Any point

---

<sup>14</sup> Attachment 1, U S WEST Response, Thornton Letter dated Aug. 18, 1998 at 3.

<sup>15</sup> "For example, one Internal Revenue Service regulation indicates that the precision of an estimate should not exceed 10% of an estimate at a 95% confidence level." Id.

<sup>16</sup> ASD Audit Report at 10.

<sup>17</sup> Attachment 1, U S WEST Response, Thornton Letter dated Aug. 18, 1998 at 4; Thornton Letter dated Jan. 8, 1999 at 3.

(i.e., value) within the range of uncertainty of an individual sampling estimate has an equal probability of being the actual amount of the error.<sup>18</sup> Thus, when utilizing sample results in an audit context, the lower end of the range of uncertainty is the only justifiable amount that can be proposed as an adjustment to the COE account balances.<sup>19</sup>

Given the flaws in the ASD's sampling methods and audit procedures discussed above, the ASD's estimates are virtually meaningless for purposes of drawing conclusions about the level of COE hardwired investment.<sup>20</sup> As such, the Commission should limit the CPR audit to its original purpose of auditing compliance with the Commission's Part 32 recordkeeping requirements.

### III. ISSUES DESIGNATED FOR INVESTIGATION

Issue 1: The validity and reasonableness of the statistical sampling methodologies used by the auditors, including: sample design, the two-stage stratified sampling technique, balance and adjustments made to account for high-cost and lower-cost items, the audit procedures, extrapolation techniques, confidence intervals, and the application of Bayesian techniques.

Response:

The ASD field audits which are the subject of the Commission's Notice covered a miniscule portion of the Companies' hardwired COE investment. For

---

<sup>18</sup> Id.

<sup>19</sup> See Attachment 2, Geppert Declaration at 10.

<sup>20</sup> Furthermore, the ASD's estimate has an inherent bias in that it only includes "overstatement" errors and did not consider "understatement" errors which were also present in the sample and would reduce the ASD's estimated overstatement. See Attachment 1, U S WEST Response, Thornton Letter dated Aug. 18, 1998 at 4. See also, Attachment 2, Geppert Declaration at 8-9. An understatement error is where the quantity of a CPR line item was less than the quantity actually found.

U S WEST, the ASD selected a sample of 33 COs -- out of a total population of over 1,700 COs -- and 36 CPR line items per office for a total of 1,188 line items out of approximately 500,000 records. This audit sample is the foundation upon which the ASD's findings and conclusions are built. If the sample is not representative of the entire population of U S WEST's hardwired COE investment, it cannot be used to produce statistically valid estimates of this population.

There are so many obvious flaws and unanswered questions associated with the ASD's sampling methodology, as applied in the U S WEST audit, that one can only conclude that neither the audit sample nor the resulting statistical estimate (i.e., extrapolation) are of any value in describing the characteristics of the overall population of hardwired COE investment. Thus, to respond to the Commission's specific inquiry, it is U S WEST's opinion that the ASD's sampling methodology is neither valid nor reasonable as it has been used in the U S WEST audit and that the ASD's findings with respect to "missing" plant simply do not pass statistical scrutiny.

In order to obtain an objective unbiased assessment of the sampling methodology that the ASD used in the audit, U S WEST engaged Ann Thornton of Deloitte & Touche, LLP in August, 1998.<sup>21</sup> U S WEST also asked Ms. Thornton to review the ASD's December report and to comment on any changes from the earlier draft report.<sup>22</sup> Ms. Thornton's letter of January 8, 1999 indicates the ASD failed to

---

<sup>21</sup> See note 7, supra.

<sup>22</sup> Ms. Thornton's review of the audit's statistical methodology was contained in Attachment 1, Tab H of U S WEST's August 19, 1998 submission (and is also

either acknowledge or respond to the vast majority of issues which she raised in her August 18, 1998 letter with regard to the ASD's sampling methodology.<sup>23</sup>

Ms. Thornton reiterates the concerns raised in her review of the ASD's earlier draft report. She states that -- due to a lack of information -- she is unable to determine whether or not the statistical estimates contained in the draft report are statistically valid or not. Despite this, Ms. Thornton raises such a broad array of questions associated with both sample selection and sample evaluation, U S WEST can only conclude that it is highly unlikely that the audit's sample results are representative of the overall population (i.e., total hardwired COE investment).<sup>24</sup> For example, Ms. Thornton notes that the ASD excluded approximately 500 out of U S WEST's 1,700 central offices from consideration for purposes of stratification and selection without any indication of the criteria employed.<sup>25</sup> Clearly, the ASD's exclusion of over 500 offices from the "population" raises significant doubts with

---

attached hereto). See Attachment 1, U S WEST Response, Thornton Letter dated Aug. 18, 1998.

<sup>23</sup> This is quite perplexing given that it is impossible to evaluate the validity of the ASD's sampling techniques without addressing the fundamental issues raised in Ms. Thornton's August 18, 1998 letter. One can only surmise that the answers to these basic questions would not have reflected kindly upon the ASD's sample selection procedures.

<sup>24</sup> Mr. Geppert also addressed Issue 1 in his attached Declaration and concluded that "the ASD did not **plan** its audit procedures to: (1) draw a statistically valid conclusion with respect to the fair presentation of COE plant account balances . . ." Attachment 2, Geppert Declaration at 8-9.

<sup>25</sup> As a result, Ms. Thornton states, "I cannot determine whether the population is appropriate for the audit objectives or whether the offices selected are likely to be representative of the population of offices." She goes on to note that "[i]f it is found necessary to replace randomly selected sample items, for whatever reason, doubts



respect to the validity of the sampling plan even before sample selection and stratification are examined.

Ms. Thornton also indicates that she has insufficient information to determine whether the stratification used was appropriate. However, she expresses concern over the large number of strata (i.e., eleven) and small number of sample selections per strata (e.g., as few as 2 offices per strata). She states “[t]here is insufficient documentation in the Draft Audit Report to justify why so many strata with relatively small sample sizes within a strata might be expected to produce representative results.”<sup>26</sup> U S WEST strongly agrees with this observation and seriously questions the “representativeness” of the sample results.

Similarly, Ms. Thornton raises the issue of the audit’s use of random selection of line items when no consideration “is given to using dollar-based selection techniques, rather than simple random selections, to allow appropriate coverage of higher dollar items.”<sup>27</sup> There can be no doubt that this is a serious flaw in sample design in an audit that covers items ranging

---

are immediately raised as to the statistical validity of the sampling plan.” Attachment 1, U S WEST Response, Thornton Letter dated Aug. 18, 1998 at 2.

<sup>26</sup> Id.

<sup>27</sup> Id. at 2-3. She states that “[t]his is particularly relevant in tests of physical existence if high-dollar items are more likely to be located than small-dollar items, due to such factors as physical size and the extent of controls over more valuable assets.” Id. Also see Attachment 2, Geppert Declaration at 8-9. Mr. Geppert states that “[t]he ASD’s sampling method, however, resulted in smaller dollar value items being as or more likely to be selected in the sample.” Id. at 8.

in value from virtually nothing to hundreds of thousands of dollars.<sup>28</sup> No one would question that it is easier to lose track of a shelf assembly with a value of approximately \$5.00 than a 5ESS side interface valued at \$40,000.

However, the audit appears to assume that if U S WEST loses a shelf assembly it is just as likely to lose a 5ESS side interface. Clearly, this is wrong -- no for-profit business would value such items equally.<sup>29</sup>

The preceding observations deal with sample selection. Of equal importance are Ms. Thornton's concerns with sample evaluation in the draft audit report. Of particular concern is the size of the precision range associated with the audit's estimate of hardwired COE plant which the auditors claim is missing. The audit estimated missing plant to lie between \$181.2 and \$576.0 million based on an estimate of \$378.6 million and precision of \$197.4 million.<sup>30</sup> Ms. Thornton observes that such estimates are of little or no value for predictive purposes.<sup>31</sup> The importance of this issue

---

<sup>28</sup> The draft audit identified nine items of less than \$5.00 where the items were "not found" or "unverifiable" by the Commission. Mr. Geppert observes that 449 or 38% of the sample items had a value of less \$2,000 and that these items accounted for approximately 3% of the total value of the 1,188 items in the sample. See Attachment 1, U S WEST Response, Geppert January 9, 1999 Declaration at 10.

<sup>29</sup> U S WEST readily acknowledges that it does not do as good a job at keeping track of \$5.00 items as it does of its digital switches. The reasons are simple -- the costs of such controls far exceed the benefits and it is highly unlikely to have a "material" misstatement of financial records as a result of errors in accounting for items of de minimis value.

<sup>30</sup> Draft Audit Report at 8.

<sup>31</sup> In pointing out that the total range of uncertainty -- \$394.8 million -- is greater than the draft audit's estimate of \$378.6 million. Ms. Thornton states:

cannot be over-emphasized -- particularly in light of the fact that no single point in the precision range is any more likely to occur than any other point from a statistical perspective.<sup>32</sup> Estimates of the precision contained in the draft audit report are of virtually no use for decision-making purposes in either a business or public service environment.<sup>33</sup>

Lastly, the estimate of missing COE investment in the audit report has an inherent bias in that it only includes "overstatement" errors and did not consider

---

Typically, I would not expect that an estimate with such a wide precision range would be useful. I would expect that it would be necessary to do additional work, either to improve the precision or to support the use of a particular point within the range. In most instances, an estimate with such large precision would be of little predictive value without the support of independent corroborative information to assist in determining whether any point in the estimated range is reasonable. Attachment 1, U S WEST Response, Thornton Letter dated Aug. 18, 1998 at 3.

<sup>32</sup> Id. Also see Attachment 2, Geppert Declaration at 10. Mr. Geppert observes that "Statistical theory states that no single value within such a range is any more likely to be correct than any other. Therefore, even if one assumes that the ASD's statistical methods and audit procedures were sufficient, which they were not, the lower end of the confidence interval is the only justifiable amount that can be proposed as an adjustment to the account balances, no matter what the underlying statistical methodology. ('Statistical Models and Analysis in Auditing,' Statistical Science, v. 4, no. 1, pp. 10-11.) The fact that the ASD's range of precision at a 95% degree of confidence is greater than the point estimate of error (i.e., \$394.8 million versus \$378.6 million) calls into question any estimate derived using the ASD's methodology."

<sup>33</sup> To put things in proper perspective, the level of precision of the ASD's estimate of missing plant, if it is to be believed, is the equivalent of saying that the population of the United States is somewhere between 120 million and 380 million people. Interesting -- but not a particularly useful piece of information for decision-making purposes.

“understatement” errors which were also present in the sample.<sup>34</sup> Ms. Thornton points out that the audit’s estimates “may be higher than they should be, in that they do not allow understatement errors to reduce estimated overstatement.”<sup>35</sup>

In addition to the deficiencies in the ASD’s sampling methodologies discussed above, the ASD’s audit procedures were similarly flawed. In order to obtain an objective unbiased assessment of the ASD’s audit procedures, U S WEST engaged Mr. Carl R. Geppert of Arthur Andersen LLP in January, 1999. Mr. Geppert’s Declaration dated January 9, 1999, attached to U S WEST’s January 11, 1999 response, details numerous flaws in the ASD’s audit plan and the audit procedures performed. As summarized in Mr. Geppert’s January 9, 1999 Declaration such flaws included:

- The use of inappropriate sampling methodologies (as discussed above).
- Lack of consideration of possible understatement of CPRs.
- Restrictive audit procedures with no follow-up site visits.
- No adjustment for timing differences during the time period from the sample selection date (June 30, 1997) to the date of the physical verification (August/September 1997).
- Failure to verify supplemental evidence submitted by U S WEST (see discussion under Issue 2 below).
- Failure to review accounting records related to hardwired COE investment.

---

<sup>34</sup> An understatement error is where the quantity of a line item on the CPR was less than the quantity actually found.

<sup>35</sup> Attachment 1, U S WEST Response, Thornton Letter dated Aug. 18, 1998 at 4. Also see Attachment 2, Geppert Declaration at 8-9. Mr. Geppert agrees with Ms. Thornton and notes in his Declaration that “the ASD’s physical verification

- Failure to review the Company's internal controls over COE CPRs in order to determine the nature, timing and extent of audit procedures to be performed.
- Failure to communicate with U S WEST management throughout the audit process in order to validate the ASD's findings and properly interpret and validate supplemental evidence as to the existence of COE assets provided by the Company.

These flaws, individually and in the aggregate, serve to undermine the credibility and validity of the ASD's findings and recommendations contained in the audit report.

For the foregoing reasons, U S WEST believes that the Commission should limit the CPR audit to its original purpose -- auditing compliance with the Commission's Part 32 recordkeeping requirements -- and not attempt to draw conclusions about the level of hardwired COE investment. The draft audit's estimate of "missing" COE investment is of questionable statistical validity and, even if accepted, is of little or no value for decision-making purposes.<sup>36</sup>

Issue 2: The validity and reasonableness of the methodology used by the Bureau's auditors in determining whether to rescore or to modify a finding during a field audit that equipment was "not found."

Response:

---

procedures were solely directed at detecting instances of potential overstatement in the plant accounting records." *Id.* at 9.

<sup>36</sup> Ms. Thornton states: "In summary, given the several questions and concerns about the sampling approach taken by the FCC, it is possible that the resulting sampling estimates may be invalid (i.e., the range of the estimate does not contain the actual amount of error in the population). Additionally, even if the estimate is in fact valid, the size of the precision range, which is very large in relation to the size of the estimate, creates doubt as to the practicality of using the range for concluding as to the actual amount of error in the population." Attachment 1, U S WEST Response, Thornton Letter dated Aug. 18, 1998 at 4.

In its simplest form the methodology that the ASD auditors used to rescore their field audit results can only be described as a “gotcha.” The ASD provided no prior notice of its “probative evidence” standard and the standard can only be described as a far stricter standard than that normally used in audits.<sup>37</sup> If anything, it appears to be a standard that was adopted after-the-fact to support the ASD’s initial field audit findings. The RBOCs were first made aware of the ASD’s rescoring methodology -- the “probative evidence” standard -- on April 7, 1999 through the issuance of the Rescore Public Notice. This was approximately eight months after U S WEST and the other RBOCs submitted their first management responses to the ASD’s initial draft audit reports and four months after the ASD’s revised audit reports were released to the companies (and approximately 1½ years after the U S WEST field audit was actually conducted). At no time prior to the release of the Rescore Public Notice (April 7, 1999), did the ASD provide the RBOCs with any indication as to the standard that would be used to modify field audit results or that the standard would significantly exceed that commonly-used under GAAS. As such, it is hardly surprising that the submissions of U S WEST and the other RBOCs failed to satisfy this “unrevealed” and “unanticipated” standard.

In response to the Commission’s direct inquiry on the validity and reasonableness of the ASD’s methodology for modifying field audit results, there can only be one answer. That is, the “probative evidence” standard is neither

---

<sup>37</sup> As Mr. Geppert points out in his Declaration: “The ASD’s ‘probative evidence’ standard is not a term of art in the auditing profession and prescribes a standard

reasonable nor valid as applied in the CPR audits. The ASD's post hoc "probative evidence" standard fails on numerous grounds. First, as Mr. Geppert points out "standards, or guidelines, should be clearly documented and communicated so that all parties have a common understanding of what will constitute a compliant item."<sup>38</sup> Revealing an evidentiary standard long after management has submitted its response to an audit is contrary to both GAAS and generally accepted government auditing standards ("GAGAS"). Second, the ASD's "probative evidence" standard is not a commonly-used auditing standard and appears to have been created by the ASD solely for this audit.<sup>39</sup> Third, the ASD failed to perform the most basic and most persuasive audit procedure -- another field visit -- to evaluate/validate management input.<sup>40</sup> Lastly, the ASD's determination that the primary, if not only, means of satisfying the "probative evidence" standard was

---

over and above that suggested by GAAS [generally accepted auditing standards]." Attachment 2, Geppert Declaration at 11.

<sup>38</sup> Id. at 13.

<sup>39</sup> See note 37, supra.

<sup>40</sup> "The ASD clearly imposed strict evidentiary standards in its review of support documentation but neglected to perform the most basic, and most persuasive, of audit procedures to verify the accuracy of such documentation and the existence of the assets in question. The auditors never returned to the field to re-verify its scoring by physical inspection or discussed the results of their scoring with the appropriate U S WEST personnel. The existence of additional audit evidence should at a minimum give rise to procedures to validate such information. Such procedures cannot properly be performed 'in a vacuum' by the ASD but rather must involve interaction with Company personnel where the merits of the additional audit evidence can be discussed and interpreted. This is especially necessary given the different forms of documentation maintained by the individual RBOCs, where different forms of documentation may be used differently from one company to the next in support of plant accounting entries." Attachment 2, Geppert Declaration at 11.

through the provision of source documentation (e.g., purchase orders, invoices, etc.) and engineering drawings<sup>41</sup> is at odds with the Commission's own rules which no longer prescribe specific record retention periods for carriers.<sup>42</sup>

Thus, the "probative evidence" standard fails on two levels. First, as Mr. Geppert explains in his Declaration, this standard is not a reasonable standard to be used in performing audits.<sup>43</sup> Secondly, even if one assumes the reasonableness of the standard, the standard was not applied in a valid manner in the CPR audits. Announcing and applying a standard after management has submitted its response can only be described as "ambush" auditing and cannot be reconciled with either GAAS or GAGAS.

Issue 3: To the extent the auditors' sampling, rescoring and other methodologies were valid, whether the degree of error in the CPR

---

<sup>41</sup> Rescore Public Notice at 2.

<sup>42</sup> In the Matter of Revision of Part 42, Preservation of Records of Communication Common Carriers, Report and Order, 60 P&F 2d 1529, 1535 ¶ 32 (1986) ("Report and Order") "we have decided to eliminate the list of records as proposed. We believe the carriers' need for the records for their own business operations and to meet the recordkeeping requirements of other agencies will assure the availability of the records needed by this Commission for regulatory purposes. If the records that we need are found not to be generally available in specific instances under this approach, this Commission can prescribe specific retention periods for such records as we are doing in this rulemaking for toll records. By eliminating the list of records the carriers' administrative burdens of compliance with our record retention requirements will be greatly reduced and carriers will have greater flexibility in determining the proper retention period for their records."

<sup>43</sup> "... GAAS recognizes that the nature and extent of audit evidence will vary among audits and that proof 'beyond a reasonable doubt' will rarely be obtained. Thus, the ASD's 'probative evidence' standard in the real world will rarely, if ever, be achieved. What GAAS (as well as GAGAS) then directs the auditor to do is to obtain additional persuasive evidence -- not ignore the documentation supplied because it doesn't meet, in the ASD's interpretation, this arbitrarily high standard." Attachment 2, Geppert Declaration at 12.



records determined by the auditors is sufficient to require corrective action.

Response:

It is virtually impossible to discuss what action, if any, would be required by a certain level (i.e., degree) of error in continuing property records without addressing sampling, rescoring and estimation techniques. As a result, the Commission's inquiry is purely hypothetical since the auditors' sampling, rescoring, and estimation methodologies were severely flawed. Furthermore, the ASD's findings with respect to the level of error in continuing property records (i.e., items not found or unverifiable) are highly suspect and are significantly higher than those of either U S WEST or Arthur Andersen (or "AA"). The ASD's draft audit report classifies 10.3% of the 1,188 CPR line items representing 8.5% of the sample value as "not found."<sup>44</sup> In a post-audit investigation of the same sample offices and line items, U S WEST was able to account for 96.0% of the items representing 98.7% of the total sample value.<sup>45</sup> In May 1999, at U S WEST's request, "AA visited three Colorado central offices included in the ASD's sample to (1) test the reasonableness of ASD's evidentiary standards described above, and (2) attempt to re-verify COE items that ASD scored as 'not found' or 'unverifiable.'"<sup>46</sup> While AA's findings differ slightly from U S WEST's post-audit investigation, AA's results contradict the ASD's claims with respect to the level of error in U S WEST's continuing property

---

<sup>44</sup> Audit Report at 7.

<sup>45</sup> Attachment 1, U S WEST Response at 11-14.

<sup>46</sup> Attachment 2, Geppert Declaration at 14.